No. 96-1938 (2)

Supreme Court, U.S.
FILED
JUL 7 1997
OFFICE OF THE CLERK

In The
Supreme Court of the United States
October Term 1996

IN RE: BAKER & GETTY FINANCIAL SERVICES, INC.,
Debtor,

WESBANCO BANK BARNESVILLE,
formerly known as The First National Bank of Barnesville,
Petitioner,

v.

CARL D. RAFOTH, Trustee,

CUSTOMER CREDITORS,
Respondents.

On Petition For Writ of Certiorari
To The United States Court of Appeals
for the Sixth Circuit

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Russell A. Kelm
Law Offices of Russell A. Kelm
37 W. Broad Street, Suite 860
Columbus, Ohio 43215
(614) 240-5900
Attorneys for Respondents

RECEIVED
JUL 11 1997
OFFICE OF THE CLERK
SUPREME COURT, U.S.

July 7, 1997

28 pp

QUESTIONS PRESENTED

I. Whether the Sixth Circuit Court of Appeals committed error in affirming the District Court's affirmance of the Bankruptcy Court's factual determination that the debtors were engaged in the business of effecting transactions in securities.

II. Whether the Sixth Circuit Court of Appeals committed error in affirming the District Court's affirmance of the Bankruptcy Court's conclusion of law that the bankruptcy estate should be liquidated under stockbroker liquidation provisions of Bankruptcy Code.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF CONTENTS	ii
TABLE OF AUTHORITIES	iii
STATEMENT OF THE CASE	1
ARGUMENT	10
CONCLUSION	23

TABLE OF AUTHORITIES

Page

Cases

Anderson v. Bessemer City, N.C., 470 U.S. 564, 565 (1985) 13

In re Baker & Getty, 106 F.3d 1255 (6th Cir. 1997) 13

In re Caldwell, 851 F.2d 852 (6th Cir. 1988), *appeal after remand*, 895 F.2d 1123 (6th Cir. 1990) 14

In re Edward M. Johnson and Associates, Inc., 845 F.2d 1395 (6th Cir. 1988)..... 13,14

In re Gibralco, Inc., 53 B.R. 324 (Bankr. C.D. Calif. 1985)..... 20

Parts and Electric Motors v. Sterling Electrical, Inc., 866 F.2d 228 (7th Cir. 1988)..... 13

Patterson v. Shumate, 504 U.S. 753 (1992)..... 18

S.E.C. v. F.O. Baroff Co., Inc., 497 F.2d 280 (2nd Cir. 1974)..... 22

Securities Investor Protection Corporation v. Pepperdine University (In re Brentwood Securities, Inc.), 925 F.2d 325 (9th Cir. 1991)..... 21

United States v. Ron Pair Enterprises, Inc., 489 U.S. 235 (1989)..... 18

Wider v. Wootton, 907 F.2d 570 (5th Cir. 1990)..... 19

Statutes and Rules

Bankruptcy Code 11 U.S.C. § 101(53A) 2,11,17-18

Bankruptcy Code 11 U.S.C. §§ 741-752..... 1,3,18-19,22

Miscellaneous

Webster's II New Riverside University Dictionary (1984) 17

STATEMENT OF THE CASE

A. The Bankruptcy Proceedings

The underlying bankruptcy proceedings began in January 1987. Since June 1987, the Chapter 7 Trustee has pursued several adversary proceedings seeking to recover assets for the bankruptcy estate. One of the adversary proceedings was against petitioner WesBanco Bank Barnesville f/k/a First National Bank of Barnesville (the "Bank"), seeking the recovery of preferential transfers in the principal amount of $245,800. The Bank fought the action, unsuccessfully, all the way to the Sixth Circuit. *See Rafoth v. First National Bank of Barnesville (In re Baker & Getty Financial Services, Inc.)*, 98 B.R. 300 (Bankr. N.D. Ohio 1989) *aff'd*, 974 F.2d 712 (6th Cir. 1992).

After seven years of these contested proceedings, the Trustee began to focus on distribution of the recovered assets. On July 1, 1994, the Trustee filed a Motion for Instructions From the Court As to the Applicability of Stockbroker Liquidation Sections of the Bankruptcy Code 11 U.S.C. § 741, *et seq.* (the "Motion for Instructions"). On July 25, 1994, the Bank filed a Memorandum in Response to the Trustee's Motion, arguing against application of the stockbroker liquidation subchapter. On August 1, 1994, the respondents herein filed a Memorandum in Support of Application of Stockbroker Liquidation Subchapter. Various other creditors filed memoranda, all of which favored application of the stockbroker liquidation rules.

On September 28, 1994, a full evidentiary hearing was held on the Motion for Instructions and the various submissions. The Bank offered no evidence at the hearing, but instead sought to rely upon prior decisions in the bankruptcy proceedings. On October 31, 1994, the Bankruptcy Court issued its order concluding that the rules for stockbroker liquidations would be applied.

B. The District Court Proceedings

On November 9, 1994, the Bank filed a Notice of Appeal from the October 31, 1994 Order of the Bankruptcy Court. The Customer Creditors filed a Motion to Strike All References to the Deposition Testimony of Daniel Schwenker and Philip Cordek from the Record on Appeal and From Appellant's Brief. (Record 9, Motion.) This Motion was denied by a Marginal Entry Order of the District Court on July 31, 1995. (Record --, Marginal Entry Order dated July 31, 1995.) Also on July 31, 1995, the District Court issued a Memorandum Opinion which affirmed the Order of the Bankruptcy Court applying the rules for stockbroker liquidations. (Record 17, Memorandum of Opinion.) After denying the Bank's Motion for a Rehearing, the District Court issued its Final Order on December 5, 1995 affirming the Bankruptcy Court. (Record 26, Order.)

C. The Proceedings in the Sixth Circuit Court of Appeals

On February 12, 1997, the Sixth Circuit found that Baker & Getty was a stockbroker pursuant to 11 U.S.C. § 101(53A) and affirmed the District Court's order

instructing the trustee to distribute the assets of the bankruptcy estate according to the stockbroker liquidation provisions of 11 U.S.C. §§ 741-752.

D. Background

To put the specific facts underlying this series of appeals in context, a brief review of the history of the case is appropriate. As noted earlier, the underlying bankruptcy action began on January 22, 1987 with the filing of involuntary petitions under Chapter 7 of the Bankruptcy Code against Baker & Getty Financial Services, Inc. ("B&G Financial Services"), Baker & Getty Diversified, Inc. ("B&G Diversified, Inc.") and Baker & Getty Securities, Inc. ("B&G Securities"). Philip Cordek and Suzan Bierman Cordek were joined in the proceedings as affiliates in April 1987. In September 1987, the bankruptcy estates of the three Baker & Getty entities, along with the bankruptcy estates of Philip Cordek and Suzan Bierman Cordek, were substantively consolidated. *See In re Baker & Getty Financial Services, Inc.*, 78 B.R. 139, 143 (Bankr. N.D. Ohio 1987). As a result of the substantive consolidation, the debtors will be referred to collectively herein as "Debtor" or "Baker & Getty."

Since 1987, there have been numerous adversary proceedings or contested matters before the Bankruptcy Court which resulted in written decisions from that Court. Seven of those were published opinions. In chronological order, the published opinions are as follows: *In re Baker & Getty Financial Services, Inc.*, 78 B.R. 139 (Bankr. N.D. Ohio 1987) (decision consolidating the bankruptcy estates); *Rafoth v. Bailey*

(In re Baker & Getty Financial Services, Inc.), 88 B.R. 792 (Bankr. N.D. Ohio 1988) (preference and fraudulent conveyance action); *Rafoth v. National Union Fire Insurance Company of Pittsburgh, Pennsylvania (In re Baker & Getty Financial Services, Inc.)*, 88 B.R. 137 (Bankr. N.D. Ohio 1988), *rev'd and remanded for new trial*, 954 F.2d 1169 (6th Cir. 1992) (addressing whether action on fidelity bond was a core proceeding); *Rafoth v. National Union Fire Insurance Company of Pittsburgh, Pennsylvania (In re Baker & Getty Financial Services, Inc.)*, 93 B.R. 559 (Bankr. N.D. Ohio 1988), *rev'd and remanded for new trial*, 954 F.2d 1169 (6th Cir. 1992) (action on the merits on the fidelity bond); *Rafoth v. The First National Bank of Barnesville (In re Baker & Getty Financial Services, Inc.)*, 98 B.R. 300 (Bankr. N.D. Ohio 1989) *aff'd*, 974 F.2d 712 (6th Cir. 1992) (preference action against the Bank, and action to equitably subordinate Bank's claim). The scope and substance of these decisions are important for two reasons. First, they demonstrate the Bankruptcy Court's complete understanding of this case. Second, in considering the issues underlying the present Petition, the Bankruptcy Court took judicial notice of the matters contained in the decisions. (*See*, Record 1, Hearing Transcript at 15-17.) With this background, the factual history of this case is appropriate.

E. <u>Formation of the Three Companies</u>

In the summer of 1985, Philip Cordek and Steven Medved decided to form a stock brokerage and financial services firm. *Baker & Getty*, 78 B.R. at 140. In August of 1985, B&G Financial Services was incorporated for this purpose. *Id.*

B&G Financial Services then began to hire employees to carry out this mission. In September 1985, B&G Financial Services hired Daniel Schwenker. Prior to joining B&G Financial Services, Mr. Schwenker had been working as a stockbroker in Florida at E. F. Hutton and Smith Barney, Harris & Upham. (*See*, Record 1, Hearing Exhibit 4 at 14.)

In October 1985, B&G Financial Services hired David Perham and Phil Hammond to be account executives. (Record 1, Hearing Transcript at 23-24.) Messrs. Perham and Hammond studied for and passed the required tests which allowed them to trade in securities. (Record 1, Hearing Transcript at 23-24.)

In an effort to promote its services, B&G Financial Services prepared an elaborate brochure. (*See*, Record 1, Hearing Exhibit 1.) This brochure noted that Messrs. Schwenker, Perham and Hammond were licensed stockbrokers and that B&G Financial Services could satisfy all of a customer's financial needs, including trading of stocks and bonds. *Id.*

These three employees of B&G Financial Services did in fact conduct transactions in securities. Mr. Perham testified at the September 28 Hearing that he conducted securities transactions, and that Messrs. Hammond and Schwenker did as well. (*See*, Record 1, Hearing Transcript at 22-30.) This is confirmed by a Statement of Account and a confirmation slip marked as Hearing Exhibit 2. (Record 1, Hearing Exhibit 2.) The actual trades were conducted by a clearinghouse known as Mutual Service Corporation. The Bank attempts to

make much of this, but as will be demonstrated below, the Bank's argument misses the mark.

B&G Diversified was formed in December 1985 to conduct real estate transactions. *Baker & Getty*, 78 B.R. at 140. In the Spring of 1986, counsel realized that there were some defects in the formation of B&G Financial Services. Thus, the principals decided to form B&G Securities to replace both B&G Financial Services and B&G Diversified. *See Rafoth v. Bailey*, 88 B.R. at 794.

The articles of incorporation for B&G Securities were filed in May, 1986. (*See*, Record 1, Hearing Exhibit 3.) Among its identified purposes for formation were:

> 1. To engage generally in the sale and management of financial products and services, **and to buy, sell, distribute, public and private stocks, bonds, debentures, certificates, warrants and options or other securities** and to generally act as a financial consultant.

(Record 1, Hearing Exhibit 3 at 1 (emphasis added).)

To carry out this purpose, in August 1986 B&G Securities filed a Uniform Application for Broker-Dealer Registration with the National Association of Securities Dealers. (*See,* Record 1, Hearing Exhibit 4.) B&G Securities also hired Gregg DeSilvio, a licensed salesman at Merrill Lynch, Pierce, Fenner & Smith, Inc., and Roxanne Torquato, from Paine, Webber, Inc., to assist in the operations. (*See*, Record 1, Hearing

Transcript at 24-28; Hearing Exhibit 4 at 9-12, 21-24.) B&G Securities also purchased a Securities Dealer Fidelity Bond. (*See*, Record 1, Hearing Exhibit 5.)

At all times, it was the intent of the Debtor to convey to the public that it was engaged in the brokerage services business for customers. Mr. Perham testified as follows:

> Q When you worked at Baker & Getty, did they have offices that you worked out of?
>
> A Yes, they did. They were located on Market Street, adjoining the Bob Stackhouse Oldsmobile Dealership.
>
> Q And were those regular working offices where people came to work everyday and customers came into?
>
> A Yes.
>
> Q And as far as you could observe while you were there, it had all the outward signs of a functioning securities broker dealer firm?
>
> A Yes, it did.

(Record 1, Hearing Transcript at 33-34; *see also* Hearing Transcript at 28-29.)

F. <u>The Ponzi Activities</u>.

At the same time that the Baker & Getty enterprise was pursuing these legitimate activities, one of its principals was pursuing some unlawful activities. Philip Cordek, an agent of the Baker & Getty entities, told prospective investors that he could arrange "block purchases" of stock through his uncle in New York. *Baker & Getty*, 78 B.R. at 140. He further told prospective investors that his uncle worked in the securities industry in New York and that the stock was available at a price below the current market price. The stock could then be sold with investors realizing a return of 20-30% in a short period of time. *Id.*

Based upon these representations, several individuals gave funds to participate in the investments. Included in the group of investors were the respondents herein. The respondents herein are James J. Baker, Lois Baker, Darrell A. Brown, Guy Brown, Rhea Caldwell, Dale L. Christman, Eldon Christy, John Jorris, Donald E. Lafferre, P.E. Ludwig, Richard Oehler, David Rubel, Gary A. Rubel, Thomas Stubbs, John G. Weber, Steve Weber and Rodney C. Wilson. These individuals are referred to collectively as the "Customer Creditors." The Customer Creditors, and numerous others, wrote checks payable to "Baker & Getty" for the express purpose of purchasing stock. (*See*, Record 1, Hearing Exhibit 6.) Thereafter, these individuals were given confirmation slips which purported to show their trades. (*See*, Record 1, Hearing Exhibit 6.)

For example, James and Lois Baker delivered two checks payable to "Baker & Getty" dated June 20 and

24, 1986 in the combined amount of $100,000 for the purpose of purchasing stock in The Limited, Inc., a company whose stock is traded on the New York Stock Exchange. In fact, Lois Baker's June 20, 1986 check expressly notes that it is for "Limited Stock." (*See*, Record 1, Hearing Exhibit 6 at 2.) Thereafter, Baker & Getty issued a purported confirmation slip reflecting the purchase of $100,000 worth of The Limited, Inc. stock on June 28, 1986. (See, Record 1, Hearing Exhibit 6 at 3.) The same pattern was followed for all of the Customer Creditors. (*See*, Record 1, Hearing Exhibit 6 at CN (Donald Lafferre); CP (David Rubel); CQ (Gary Rubel); CR (John Weber); CS (Steve Weber); and CT (Rodney C. Wilson).)

Unfortunately, this "block" investment scheme was a total fabrication, and was in fact operated as a Ponzi scheme. When the Customer Creditors learned of these actions, they filed the involuntary petitions. Through the bankruptcy proceedings, the Customer Creditors and others similarly situated have suffered losses of over $2,000,000.

G. The Bank's Claim

Since 1987, the Trustee has pursued several adversary proceedings and other actions to recover funds for the estate. Many of these actions were vigorously contested. One such action was against the Bank to recover preferential transfers in the principal amount of $245,800. The Bank contested this action all the way to the Sixth Circuit, losing at each level. *See Rafoth v. First National Bank of Barnesville*, 98 B.R. 300, *aff'd*, 974 F.2d 712.

The Bank has always proceeded as if Baker & Getty was a stockbroker. The Bank's claim is based upon a loan it made in August 1986 in the original amount of $1,100,000. This loan was made to Byron Rice (an existing Bank customer) and Philip Cordek. The funds were to be used to purchase municipal bonds. *See In re Baker and Getty Financial Services, Inc.*, Case No. B87-00074-Y, slip op. at 3 (Bankr. N.D. Ohio June 23, 1988) (a copy of which appears in the Appendix at A-1 attached to the Customer Creditors' Brief in the Sixth Circuit Court of Appeals filed on April 8, 1996). The loan was supposed to be fully secured by collateral from Mr. Rice with a value of over $2,000,000. *Id.* at 2. The Bank failed to take the steps necessary to perfect its security interests, and in fact obtained collateral with a value of only $55,000. *Id.* at 4.

In short, the Bank had an opportunity to protect itself by simply taking the ministerial steps necessary to perfect its security interests before loaning the money. For whatever reason, it chose not to do so. The Customer Creditors, on the other hand, never had an opportunity to protect themselves. As will be explained in further detail below, this presents a compelling rational basis to support the very *raison d'etre* for the stockbroker liquidation subchapter of the Bankruptcy Code.

ARGUMENT

Baker & Getty was properly determined to have functioned as a stockbroker and its liquidation should be conducted under the appropriate rules for that type of

business so that its customers are protected. The Bankruptcy Court correctly held that Baker & Getty was a stockbroker under the applicable sections of the Bankruptcy Code. Baker & Getty was engaged in the business of effecting transactions in securities, as the Bankruptcy Court correctly held. The District Court and the Sixth Circuit Court of Appeals each properly affirmed the holdings of the lower courts.

The arguments put forth by petitioner in its Petition do not satisfy Rule 10 of the Supreme Court Rules which mandates the presence of "compelling reasons" for the granting of a petition for a writ of certiorari. The question that petitioner seeks to present is simply a fact-bound application of well-established law. As such, review by this Court would be inappropriate.

I. THE LOWER COURTS PROPERLY CONCLUDED THAT THE DEBTOR IS A STOCKBROKER FOR PURPOSES OF THE STOCKBROKER LIQUIDATION SECTIONS OF THE BANKRUPTCY CODE

The Bank's first argument is that the Sixth Circuit erred in upholding the factual determination that the Debtor is a stockbroker. As will be demonstrated below, this factual finding was correct and review by this Court should be denied.

To be considered a "stockbroker" under 11 U.S.C. § 101(53A), a debtor must be a person (1) with respect to which there is a customer; and (2) that is engaged in the business of effecting transactions in securities either for the account of others or with members of the public,

from or for such person's account. The lower courts correctly determined that both elements are present in this case and the Sixth Circuit correctly affirmed the lower courts.[1]

A. The Debtor Company Was Engaged in the Business of Effecting Transactions in Securities.

The Bankruptcy Court concluded as follows:

> There is no dispute that the Debtor defrauded investors. **The evidence in the record, however, shows that Debtor did effect transactions in securities**. At a hearing on this matter, counsel for the Customer Creditors called David Perham to testify that he engaged in the business of effecting stock transactions. Perham is a licensed stockbroker who worked for Debtor during the relevant period. Perham testified that he accepted money from customers and conducted transactions in securities. Perham further testified that he personally knew of other brokers performing similar functions. Furthermore, the Court is aware from other hearings in the bankruptcy case of instances where Debtor informed investors that it had bought and later sold securities for the investors' accounts. **From this evidence, the Court concludes that Debtor has effected transactions in securities**.

---

[1] Petitioner concedes that respondents meet the definition of "customer" and, therefore, the first part of this two-part test is satisfied.

(Record 1, October 31, 1994 Bankruptcy Court Order at 3-4.) (emphasis added). The District Court held that the bankruptcy court had sufficient evidence to determine that Baker & Getty engaged in the business of effecting transactions in securities. (Record 17, Memorandum of Opinion at 8-9.) The Sixth Circuit also concluded that WesBanco's argument that Mutual Services, but not Baker & Getty, "effected transactions in securities" was without merit. *In re: Baker & Getty*, 106 F.3d 1255, 1261 (6th Cir. 1997).

The Bank has conceded that this is a factual finding, subject to the clearly erroneous standard of review. *See* Bankruptcy Rule 8013. This Court has repeatedly held that a "finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with a definite and firm conviction that a mistake has been committed." *Anderson v. Bessemer City, N.C.*, 470 U.S. 564, 565 (1985), quoting *United States v. United States Gypsum Co.*, 333 U.S. 364, 394-395 (1948). The Sixth Circuit has "clearly enunciated that findings of fact of a bankruptcy court should not be disturbed unless there is 'most cogent evidence of mistake or miscarriage of justice.'" *In re Edward M. Johnson and Associates, Inc.*, 845 F.2d 1395, 1401 (6th Cir. 1988), *quoting Slodov v. United States*, 552 F.2d 159, 162 (6th Cir 1977), *rev'd on other grounds*, 436 U.S. 238 (6th Cir), *on remand*, 579 F.2d 400 (6th Cir. 1978). In what is perhaps the most artfully phrased enunciation of what is meant by clearly erroneous, the Seventh Circuit in *Parts and Electric Motors v. Sterling Electrical, Inc.*, 866 F.2d 228 (7th Cir. 1988) stated:

> **To be clearly erroneous, a decision must strike** us as more than just maybe or probably wrong; it must, as one member of this court recently stated during oral argument, strike **us as wrong with the force of a five-week-old, unrefrigerated dead fish**.

866 F.2d at 233 (emphasis added).

In *In re Caldwell*, 851 F.2d 852 (6th Cir. 1988) the Sixth Circuit noted that:

> **[a district court] may not make its own independent factual findings**. If the bankruptcy court's factual findings are silent or ambiguous as to an outcome determinative factual question, the district court may not engage in its own fact finding but, instead, must remand the case to the bankruptcy court for the necessary factual determination. *E.g. In re Walker*, 726 F.2d 452, 454-55 (8th Cir. 1984); *In re Neis*, 723 F.2d 584, 588-90 (7th Cir. 1983).
>
> *Edward M. Johnson and Associates*, 845 F.2d at 1401 (quoting *Wegner v. Grunewaldt*, 821 F.2d 1317, 1320 (8th Cir. 1987)).

851 F.2d at 857 (emphasis added). As demonstrated above, the bankruptcy court in the instant case was not silent as to "an outcome determinative question," and made a finding of fact that the Debtor was effecting transactions in securities. The District Court

appropriately affirmed the Bankruptcy Court's factual findings, and the Sixth Circuit appropriately affirmed the District Court.

There was more than enough evidence in the record to support this finding. David Perham testified that he and others conducted transactions in securities. (Record 1, Hearing Transcript at 22-30.) This is confirmed by Hearing Exhibit 2, which consists of account statements and a confirmation slip from actual transactions. (Record 1, Hearing Exhibit 2.) Other evidence in the record includes the sales brochure (Record 1, Hearing Exhibit 1), the Form BD filed with NASD (Record 1, Hearing Exhibit 4), and the Articles of Incorporation (Record 1, Hearing Exhibit 3). Furthermore, according to the Bankruptcy Court's order, it also based its decision on its knowledge "from other hearings in the bankruptcy case of instances where Debtor informed investors it had bought and later sold securities for the investors' accounts." (*See* Record 1, October 31, 1994 Order at 4.) In the first published decision in this case, the Bankruptcy Court concluded as follows:

> There are three Corporate Debtors involved in this case. **BAKER & GETTY FINANCIAL SERVICES, INC. ("BGFS") was formed August, 1985 to effect transactions in securities and to operate as a broker dealer**. In fact, BGFS held itself out as a fully licensed broker dealer and a member of the Securities Investment Protection Corporation, although it apparently never became fully licensed. The second Debtor implicated in this case is BAKER & GETTY DIVERSIFIED, INC.

> ("BGD"). This entity was formed in December, 1985 to locate and develop real estate investment opportunities for customers of the brokerage firm and to loan funds to BGFS. BAKER & GETTY SECURITIES, INC., ("BGS") was formed in June, 1986 to replace both BGFS and BGD. BGS subsequently filed an application to become a licensed broker dealer in August, 1986, but its application was later withdrawn. Nevertheless, it held itself out as a licensed broker dealer.

Baker & Getty, 78 B.R. at 140 (emphasis added).

In an effort to refute this evidence, the Bank has resorted to an attempt to refer to the deposition transcripts which are not part of the record in this case since they were never offered or produced at trial and never admitted in evidence. The Bank relies heavily upon the deposition testimony of Daniel Schwenker and Philip Cordek. *See* Bank's Brief at 11, 14-16, 18-19 and 25. These transcripts are not part of the record. Simultaneously with the filing of their Brief in the District Court, the Customer Creditors filed a Motion to Strike all References to the Deposition Testimony of Daniel Schwenker and Philip Cordek from the Record on Appeal and from Appellant's Brief. (Record 9, Motion to Strike.) The Motion to Strike was denied pursuant to a Marginal Entry Order of the District Court. (Record --, July 31, 1995 Marginal Entry Order.) The Sixth Circuit did not rule on the cross-appeal because it found the testimony of David Perham alone provided adequate support to affirm the District Court's order.

However, even upon review of the deposition transcript of Mr. Schwenker, his testimony only confirms Mr. Perham's testimony. Mr. Schwenker admits that he conducted trades throughout 1985 and 1986, through one or more clearing agencies. (*See*, Record 1, Schwenker Deposition Transcript at 5-10, 36-46, 55-62 and 76.)

Recognizing that those were in fact legitimate securities transactions conducted by officers and employees of the Debtor, the Bank argues that the transactions do not relate to Baker & Getty since the trades were cleared through one or more clearinghouses. (Bank's Brief at 23-29.) Following this disingenuous argument, a firm such a Merrill Lynch Pierce, Fenner & Smith, Inc. would not be a stockbroker if a separate affiliate or entity actually conducted the trades. This argument fails for at least two reasons. First, the general public cannot be expected to know the intimate details of how a security is traded. What the general public knows is that there are businesses which hold themselves out as capable of conducting securities transactions. (*See* Record 20, August 15, 1995 Hearing Transcript at 32-33.)

Second, and more importantly, the Bank's argument flies in the face of the plain language used in the Bankruptcy Code. A stockbroker is defined as an entity which is "engaged in the business of **effecting** transactions in securities." 11 U.S.C. § 101(53A). The term "effecting" means "something brought about by an agent or cause," or "the capacity to achieve the desired result." Webster's II *New Riverside University Dictionary* at 418 (1984). The term "effecting" is much

broader and more inclusive than a term such as "conducting." Applying the plain meaning of the term, the Debtor in fact effected transactions in securities when it caused the trades to occur. The plain language of the definition of stockbroker should be applied. *See Patterson v. Shumate*, 504 U.S. 753 (1992); *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989).

In short, there was ample evidence that the Debtor effected transactions in securities. Baker & Getty expressly held itself out to be a stockbroker, fully capable of effecting trades. Mr. Perham testified, and documents confirm, that trades were conducted. The fact that Baker & Getty never became licensed, and that its agents and clearinghouses may have actually cleared the trades, are immaterial. The Bankruptcy Court's factual finding that the Debtor effected transactions in securities was properly affirmed by the District Court and the Sixth Circuit.

II. THE STOCKBROKER LIQUIDATION PROVISIONS OF THE BANKRUPTCY CODE APPLY IN THIS CASE

Because both elements of the definition of a stockbroker contained in 11 U.S.C. § 101(53A) have been satisfied, the Bankruptcy Court properly directed the Trustee to distribute the Debtor's assets pursuant to 11 U.S.C. §§ 741-52. The cases cited by the Bank in support of its position that the stockbroker liquidation sections of the Bankruptcy Code should not apply are hardly persuasive and are clearly distinguishable from the instant case.

For example, in *Wider v. Wootton*, 907 F.2d 570 (5th Cir. 1990) the court held that the debtor, (who coincidentally operated a "Ponzi" securities investment scheme) was not a "stockbroker" because it did not have a customer. The Customer Creditors acknowledge that the *Wootton* court denied the creditor's customer status under 11 U.S.C. § 741(2)(A). However, the court then looked to see if the creditors fell within 11 U.S.C. § 742(2)(B)(ii), the section which the Customer Creditors contend applies to the instant action. The *Wootton* court held that because the factual record indicated that the creditors seeking "customer" status deposited money with the debtor **after the debtor obtained a certificate and sent a confirmation slip**, and thus failed to provide the debtor with a reservoir of cash from which to purchase the securities, they were not customers as defined by 11 U.S.C. § 741(2)(B)(ii). Thus, the *Wootton* court **did not base its decision**, which denied the creditors customer status under 11 U.S.C. § 741(2)(B)(ii), on the fact that the debtor was operating a Ponzi scheme, as appellant would lead the Court to believe. Rather, the *Wootton* court denied them customer status on the basis that they did not provide the debtor with a reservoir of cash from which to purchase securities. In the instant case, the Customer Creditors first deposited funds with the Debtor and then received confirmation slips. Therefore, based upon *Wootton* itself, the Customer Creditors are customers under Section 741(2)(B)(ii).

The Bank argues that the debtors' sole function was to operate as a Ponzi scheme. (Bank's Brief at 17-19.) That is simply not true. Baker & Getty was attempting

to obtain its broker dealer license, and hired several licensed, experienced salesmen. It is not credible to argue that these individuals would have left their stable, secure positions with respected firms to knowingly work at a place where the sole function was to operate as a Ponzi scheme. Instead, Baker & Getty was pursuing lawful objectives, but had the misfortune of having Philip Cordek around, who was himself pursuing the unlawful activities.

In *In re Gibralco, Inc.*, 53 B.R. 324 (Bankr. C.D. Calif. 1985), the court granted defrauded customers claims under SIPC and quoted the following language from a Sixth Circuit decision:

> . . . It is not likely that Congress, in seeking to protect the assets of small transaction customers of broker-dealers, intended to make eligibility for protection depend on whether the broker complied with rules of the SEC or practices of the trade. These are matters over which the broker has complete control. **The trusting customer is not to be penalized for choosing a careless, unethical or dishonest broker. The primary purpose of the Act is to assure the unsophisticated participant in securities transactions that there is protection when a bad choice of brokers is made**.

53 B.R. at 329 (emphasis added), quoting *S.E.C. v. Ambassador Church, Finance/Development Group, Inc.*, 679 F.2d 608 (6th Cir. 1982), *cert. denied*, 479 U.S. 850 (1986), *on remand*, 579 F.2d 400 (1978).

The Bank cites *Securities Investor Protection Corporation v. Pepperdine University (In re Brentwood Securities, Inc.)*, 925 F.2d 325 (9th Cir. 1991), as indirect support for its contention that the Debtor was not a stockbroker. In *Brentwood*, Brentwood Securities was a licensed broker dealer, and Mr. Delahunty was its principal. Mr. Delahunty convinced two investors to purchase stock in an issuer named Comstock Mining. The two investors wrote checks directly to Comstock Mining. When Brentwood Securities failed, the two investors filed claims against it. 925 F.2d at 326-28.

The Ninth Circuit had no trouble concluding that the two investors were not customers of Brentwood Securities, since the invested funds never passed through its accounts and there was no record of these trades. The court stated: "To recover they must establish that they entrusted either cash or securities to Brentwood prior to its insolvency. . . ." 925 F.2d at 325. In the present case, the Customer Creditors in fact deposited money with the Debtor to effect transactions in securities. Under the rationale of *Brentwood*, the Debtor had customers.

Finally, it should be noted that the instant action would not be before this Court had the Bank simply perfected its security interest in collateral offered to secure its loan. *See Baker & Getty*, June 23, 1988 slip op. at 2-4 (Customer Creditors' Sixth Circuit Brief Appendix at A-1). Investors like the Customer Creditors, however, have no way to protect their money entrusted to a stockbroker. That is the primary reason why the Securities Investors Protection Act and the stockbroker liquidation sections of the Bankruptcy Code were adopted. Congress added the stockbroker

liquidation sections to the Bankruptcy Code in 1938 to protect unsophisticated customers. In *S.E.C. v. F. O. Baroff Co. Inc.*, 497 F.2d 280 (2nd Cir. 1974) the court stated:

> Both the legislative history of that provision and its use since enactment have stressed protection to and equality of treatment of the public customer who has entrusted securities [cash] to a broker for some purpose connected with participation in the securities market.

497 F.2d at 283. Since the Customer Creditors had no means of securing their position, they are afforded the priority over general creditors of 11 U.S.C. §§ 741-52.

The Bankruptcy Court's decision to apply the stockbroker liquidation provisions of the Bankruptcy Code was consistent with the intent of Congress to give a priority to unsophisticated and unknowing customers over general creditors and the District Court properly affirmed that decision.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

Russell A. Kelm
Law Offices of Russell A.. Kelm
Suite 860
37 W. Broad Street
Columbus, Ohio 43215
(614) 240-5900
Attorneys for Respondents

July 7, 1997